

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 04-970334

**Sales and Use Tax
For The Period: 1993-1995**

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ISSUES

I. Sales/Use Tax: Various Items Used in Farming

Authority: IC 6-2.5-5; 45 IAC 2.2-5

The taxpayer protests the assessment of sales/use tax on a variety of items enumerated below.

II. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1

The taxpayer protests the assessment of a 10% negligence penalty.

STATEMENT OF FACTS

The taxpayer is a farming partnership that grows various field crops (*e.g.*, corn, soybeans) and raises turkeys and hogs. The taxpayer also has a herd of beef cattle. The taxpayer protests a myriad of items as being exempt under the agricultural provisions of the Indiana Code. Given the number of protested issues, the Letter of Finding will be structured using the sub-headings that the taxpayer used in its brief to the Department. More facts will be added as needed.

At the outset, it should be noted that tax exemptions "are strictly construed against the taxpayer" and that the taxpayer bears the burden of demonstrating entitlement to an exemption. (*See Sony Music Entertainment, Inc. v. State Bd. of Tax Comm'rs*, 681 N.E.2d 800, 801 (Ind. Tax Ct. 1997)).

I. Sales/Use Tax: Various Items Used in Farming

DISCUSSION

1. Tobacco Barn

The taxpayer, after a labor intensive cutting of tobacco, hangs the tobacco “sticks” in a barn to air dry. The tobacco is moist and must be allowed 60 to 90 days to air dry. A stick of tobacco weighs anywhere from 70 to 90 pounds before drying. After it has dried, a stick weighs around 10 pounds. At that point, the stick is ready to be sold. The taxpayer cites Information Bulletin #9 for the proposition that a tobacco barn is tax exempt. Information Bulletin #9 paragraph (B)(3) contains the following hypothetical example:

Sam Johnson owns 800 acres and grows wheat . . . Sam purchased lumber, nails, concrete and tools to build a silo to house his grain drying operation. The lumber and other building materials are exempt from tax. The silo is exempt from tax because it is integral and essential to the processing of grain.

While at first glance taxpayer’s tobacco barn appears similar to the silo described in the above example, the taxpayer’s tobacco barn is actually analogous to a ripening room as described in Indianapolis Fruit Co., v. Department of State Revenue, Cause No. 49T10-9702-SC-00129 (Ind. Tax Ct. 1998). The pertinent facts in Indianapolis Fruit are as follows: Indianapolis Fruit bought tomatoes, washed and dried the tomatoes, allowed them to ripen, and then sorted and packaged the tomatoes. Indianapolis Fruit did not expedite the ripening process via the use of gases, instead “it passively awaited the ripening of the tomatoes.” Id. at 12. The Tax Court stated:

Undoubtedly, the use of the *ripening rooms* facilitated the tomatoes’ ripening, but this does not alter the conclusion that Indianapolis Fruit’s operation with respect to the tomato ripening was essentially passive in nature. (Emphasis added)

Id. The court went on to find that Indianapolis Fruit was not entitled to the manufacturing exemptions with regard to tomatoes. The taxpayer’s barn is similar to the ripening rooms. The ripening rooms were a place for the tomatoes to simply ripen, without inducement from Indianapolis Fruit. The tobacco barn is a place for tobacco to “air dry” without any inducement from the taxpayer. It might be objected that Indianapolis Fruit pertains to manufacturing and the manufacturing exemptions, whereas the taxpayer is within the rubric of the agricultural exemptions. This argument is without merit. Both the manufacturing and agricultural exemptions track each other—they both employ a “double direct test” (See IC 6-2.5-5-3 and IC 6-2.5-5-1), and both deal with the production/growing of scarce economic goods. Further, a canon of statutory interpretation is that we should construe statutes using the same language the same way (*In pari Materia*).

It should also be noted that Information Bulletin #9 is not at cross-purposes with Indianapolis Fruit. The grain silos affirmatively dry the grain—by use of fans—and silos, unlike tobacco barns, are specifically dealt with by the Indiana Administrative Code (see 45 IAC 2.2-5-7 for exemptions dealing explicitly with grain production; Information Bulletin #9 speaks specifically of a grain silo). Thus the tobacco barn would come within the scope of the holding in Indianapolis Fruit and the grain silo would fall under Information Bulletin #9 paragraph (B)(3) and 45 IAC 2.2-5-7.

FINDING

The taxpayer's protest is denied.

2. Direct Production Items

The taxpayer uses a pallet fork to load bags of seed and fertilizer from a truck or wagon into a drill. The brush auger takes the seed out of the wagon and puts the seed into the drill itself. Taxpayer cites Information Bulletin #9 paragraph (B) and 45 IAC 2.2-5-3(b) for the proposition that the items are exempt. The taxpayer makes no argument, and instead merely supplies conclusory language that "agricultural machinery, tools and equipment are exempt."

The auditor argues that the pallet fork and the brush auger are items of convenience, used to assist the farmer. However, 45 IAC 2.2-5-6(d)(9) states that "machinery, tools, and equipment used to move exempt items such as *seeds*, plants, *fertilizers*, insecticides, and fungicides from temporary storage to the location where such will be used in an exempt process" are exempt. (Emphasis added)

FINDING

The taxpayer's protest is sustained.

3. Tools and Safety Equipment; Rat Bait

The taxpayer initially protested the assessment of tax on grease and repair parts, but in the hearing the taxpayer characterized the items as hand tools used to repair tractors, combines, and planting equipment. The auditor also calls the items at issue hand tools. The taxpayer also contends that safety equipment (*e.g.*, earplugs, gloves for turkey handling—due to the claws) that it uses is exempt. The auditor did not assess tax on safety equipment used to handle anhydrous ammonia (given its toxic nature), but did assess tax for items that were not essential for the protection of life and limb.

With regard to the hand tools, 45 IAC 2.2-5-4(c) specifically states that "All tools, including

forks, shovels, hoes, welders, power tools, and hand tools” are taxable.

Safety clothing and equipment which is required to allow a farmer to participate “in the production process without injury or to prevent contamination of the live stock or commodity” is exempt under 45 IAC 2.2-5-6(d)(11). The auditor notes that the only injuries that will be suffered are blisters and headaches, but that life and limb are not in danger.

The taxpayer also contends that rat bait that was used in the seed house to keep the seed safe is tax exempt. Taxpayer does not cite any statute, regulation, or bulletin for why rat bait is directly involved in the direct production process.

FINDING

The taxpayer is denied with regard to the hand tools; taxpayer is sustained with regard to the safety equipment. The taxpayer is denied with regard to the rat bait.

4. Maintenance of a Grain Leg

Taxpayer was assessed for paint purchased to be applied to a grain leg and other equipment and buildings (*e.g.*, bulldozer). 45 IAC 2.2-5-4 specifically states that paint and brushes are taxable.

FINDING

Taxpayer is denied.

5. Cattle Gates/Cattle Fence

The Indiana Administrative Code (45 IAC 2.2-5-4) defines fences, posts, gates and fencing materials as taxable. In order to be exempt, the fencing must be used to enclose an area for one of the following exempt functions: breeding, gestation, farrowing, calving, nursing or finishing.

The auditor states that the taxpayer purchased the fencing and gates to merely establish perimeters for the grazing land. This serves two functions according to the auditor: (1) it keeps the cattle from wandering onto adjacent land and (2) allows the farmer control of the pastureland. Also, the auditor states that only a “very minute” portion of the miles of fencing was used for the calving area. The portion was less than one percent of the total amount purchased.

The taxpayer states that fencing and gates were used for holding areas for the cow/calf operation and that the cows are within one of the exempt functions at all times. The taxpayer states that there are 10 lots per farm and that the fencing was used on the lots.

Information Bulletin #9 paragraph (B)(1) states that fencing used to simply maintain a herd and

to keep the cattle from roaming is taxable. Per the auditor, this is how the fencing and gates were used.

FINDING

The taxpayer's protest is denied.

6. Maintenance of Exempt Items

Taxpayer next protests tax assessed on bolts, cleaning supplies (including wax, window cleaner), tire patches, belts, etc. As consumables, the items can be used for a variety of things on the farm. They are not machine specific. The items were included as a part of the general inventory of the farm's repair and maintenance shop. The taxpayer argues that the tire patches were used for repairing tractors and combine tires. No evidence to that effect was given.

Cleaning supplies are taxable, as 45 IAC 2.2-5-6(e)(3) makes clear.

FINDING

The taxpayer is denied.

7. Uniform Rental

Taxpayer argues that the rental of uniforms is a service and not a taxable transaction. The uniforms were ordinary work clothes with no special features, worn by the taxpayer's employees while doing field work. The Indiana Code plainly states that the rental or leasing of personal property is taxable (IC 6-2.5-4-10). 45 IAC 2.2-4-27 also states that the "renting or leasing [of] tangible personal property [is] taxable."

Further, 45 IAC 2.2-5-4(c) states that "Items of personal apparel, including footwear, gloves, etc., furnished primarily for the convenience of the workers" are taxable.

FINDING

The taxpayer is denied.

8. Construction Materials

Taxpayer argues that tax was incorrectly assessed on electrical materials used for a shop welder and a rental house. The taxpayer cites no statute, regulation, or bulletin for the exemption.

Per the Indiana Code 6-8.1-5-1, the Department's assessment is prima facie evidence that the

assessment is valid. The taxpayer has the “burden of proving that the proposed assessment is wrong.” The taxpayer, by merely concluding that the items are exempt without any argument, has not met its burden. It should also be noted that 45 IAC 2.2-5-4(c) states that “electrical supplies” are taxable.

FINDING

The taxpayer is denied.

9. Rainsuits, Boots, and Gloves

Taxpayer protests the assessment of tax on rainsuits, boots, and gloves worn while loading/unloading turkeys during rain and inclement weather. The taxpayer contends that the rainsuits and boots are for safety, yet in the hearing the taxpayer noted the convenience of wearing them during the rain. Given that the suits and boots do not prevent injury or prevent contamination, they are taxable under 45 IAC 2.2-5-4(c).

The gloves however, given the nature of the claws of the turkey, are exempt for safety reasons (see sub-heading 3 *supra*).

FINDING

The taxpayer is denied with regard to the rainsuits and boots, but sustained with regard to the gloves.

10. Tools for Repair Picked Up Twice

Although the taxpayer is denied with regard to its protest of hand tools (see sub-heading 3), the taxpayer points out that various invoices were picked up twice by audit.

FINDING

Audit is instructed to examine the highlighted items in the taxpayer’s brief at tab 15.

11. Duct Tape Used in Turkey House

Taxpayer purchased duct tape and states that it was used to tape together a cardboard confinement fence for young turkeys and to tape a feeder for the turkeys. The auditor states that the sheer number of rolls purchased demonstrates that the duct tape was used for additional purposes.

FINDING

Taxpayer's protest is denied.

12. Lockset

According to the taxpayer, he is required by various regulations to keep seed, fertilizer, and chemicals locked. Taxpayer changes the locks when there is employee turnover.

The locks prevent theft. They have no immediate direct effect upon the crops—that is, they are not essential and integral in the production process. Also, when installed, a lock becomes part of the real property and is taxable under 45 IAC 2.2-5-6(e)(2).

FINDING

Taxpayer's protest is denied.

13. Tarp for Seed Wagons

Taxpayer protests the imposition of tax on a tarp used to protect seed from dust and rain before planting. No enumerated exemption is cited (that is, neither the Indiana Code nor the Administrative Code deal with tarps), instead the taxpayer relies on the language of Information Bulletin #9 that "agricultural machinery, tools and equipment are exempt from sales and use tax if the machinery, tools and equipment are directly used in the direct production, extraction, harvesting or processing of agricultural commodities." The tarp serves no positive function within the production process, it merely provides a negative good of preventing the seed from getting dust or water on it. Given that the tarp is not used in the direct production process, it is taxable.

FINDING

Taxpayer's protest is denied.

14. Turkey House Bedding

Taxpayer states that agricultural lime and so-called "waste" (rock that does not meet state specifications on public roads) are one and the same thing. Taxpayer contends that it would clean out the turkey bedding (remove manure, etc.) in the turkey house, and then apply "waste" and shavings to level out the floor.

The auditor states that the taxpayer indicated that the "waste" was used on the barnyard lot and that agricultural lime was used on the turkey house floor. Further, in order to verify that

agricultural lime and “waste” are not one and the same thing, the auditor called the stone company from where it was purchased. The invoices also show the items to be different (waste and agricultural lime have separate lines and product codes). The hearing officer also telephoned the stone company and was told that agricultural lime was different from waste.

Given the discrepancy between what the taxpayer states the waste is used for and what the auditor contends the waste was used for (not to mention the fact that the invoices buttress the auditor’s statement), the taxpayer has not overcome its prima facie burden.

FINDING

Taxpayer’s protest is denied.

15. BackHoe Repair Parts

Taxpayer states that a backhoe was used for exempt purposes (to clean and change the turkey house bedding). The taxpayer also states that the backhoe was used to bury dead turkeys. The auditor states that the backhoe was used for digging and trenching jobs around the farm.

Taxpayer has not met its prima facie burden.

FINDING

Taxpayer’s protest is denied.

16. Agricultural Chemical Marking Dye (Water Softener)

When the taxpayer plants a crop such as corn, a line of dye is spread at each side of the planter to mark the location of the last row planted. The dye makes it easier to see where to begin the next lap through the field. The tank that contains the dye also contains a water softener.

The taxpayer argues that the markings are necessary to prevent duplication of work. It is worth noting that the dye is used concurrent with the planting process (which is part of the direct production process).

FINDING

The taxpayer is sustained.

17. Environmental Law Books

Taxpayer purchased an environmental law book from a not-for-profit organization. The taxpayer

argues that the book is exempt under 45 IAC 2.2-5-8 as integral and essential in the direct production process. The exemption speaks of machinery, tools and equipment, not law books. The law books are clearly taxable under 45 IAC 2.2-5-3(d)(8), which states that “farm management and administration” items are taxable.

In the alternative, the taxpayer argues that since the book was bought from a not-for-profit organization, that it does not owe tax on the books. Information Bulletin #10 does in fact provide that sales by a qualified organization of books to educate and improve the skills of its members are exempt from sales tax.

FINDING

The taxpayer’s protest is sustained.

18. Calf Feeder

Taxpayer protests the imposition of tax on a calf feeder used in the direct feeding of livestock. 45 IAC 2.2-5-6(d) states that “Feed-Sales of agricultural machinery, tools, and equipment used by the purchaser directly in the feeding exempt animals . . . are exempt from tax.”

FINDING

The taxpayer’s protest is sustained.

19. Bush Hog Power Takeoff

The bush hog mower is used to cut weeds and mow USDA set aside acres. Taxpayer argues that mowing the set aside acres (where no crops are grown), is part of the production process. However, the federal set aside program is to prevent production, and the taxpayer’s convoluted argument that “non-production” is part and parcel of production is not tenable.

FINDING

The taxpayer’s protest is denied.

20. Grain System Driveway

Taxpayer had a stone company put stone on the driveway to the grain system. Taxpayer argues that this was necessary in order to allow the trucks to get to the grain system. Taxpayer does not cite any enumerated exemption for this proposition, and instead attempts to equate a driveway with a structure (*i.e.*, a building, silo, barn, etc.). The Department does not find the taxpayer’s argument persuasive.

FINDING

The taxpayer's protest is denied.

II. Tax Administration: Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. The negligence penalty subjects a taxpayer to a ten percent penalty if the taxpayer incurs a deficiency that is due to negligence. *See* IC 6-8.1-10-2.1. The taxpayer bears the burden of proving that the deficiency was not due to negligence, but was due to reasonable cause. As 45 IAC 15-11-2 states:

(b) "Negligence: on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer.

The taxpayer had no exemption certificates on file for the audit period. The taxpayer also made many purchases from out-of-state suppliers who did not charge the taxpayer sales tax and the taxpayer failed to accrue and remit use tax for the items.

FINDING

The taxpayer's protest is denied.

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